

# REAL PROPERTY SECTION OF THE MISSISSIPPI BAR NEWSLETTER JUNE 2010

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## UPCOMING SECTION MEETING

The Real Property Section will meet on **Thursday, July 8, 2010** at 10 am at the Mississippi Bar's Annual Meeting at the Sandestin Hilton. Michael Martz will discuss ethics, including recent problems with real estate closings, and Sean Culhane will provide updates on RESPA and Good Faith Estimates.

## CGL MAY COVER SUBCONTRACTOR NEGLIGENCE

*Architex Association, Inc. v. Scottsdale Insurance Co.*, 27 So.3d 1148 (Miss. 2010). CIS, an owner of land, entered into a contract in 2000 with Architex, a contractor, to construct a hotel on the land. Architex hired subcontractors to perform part of the work. In September 2004 CIS notified Architex that "testing had revealed serious rebar deficiencies in the foundation" and asserted that the building was a total loss. Architex notified its liability insurer, Scottsdale, of this claim and asserted that the claim by CIS regarding the rebar constituted an "occurrence" under Architex's commercial general liability (CGL) policy. The policy contained standard language that the insurance applied to "property damage" that occurs during the policy period, and defined an "occurrence" as an accident. Scottsdale denied that the claim on the basis that no "accident" or "occurrence" existed. Architex filed an action in Rankin County Circuit Court against Scottsdale in 2006 for Scottsdale's failure to provide coverage. Scottsdale filed a motion for summary judgment arguing that it did not have a duty to defend because Architex's hiring of the subcontractor was not an "accident" but an intentional act. The Circuit Court granted Scottsdale's motion for summary judgment and dismissed Architex's complaint against Scottsdale. On appeal by Architex, the Mississippi Supreme Court, in a decision by Justice Randolph, reversed. The Supreme Court held that, in the context of a contractor/subcontractor relationship, unexpected property damage caused by a subcontractor could be an "accident" that caused "property damage" under the terms of the policy, and that negligence of a subcontractor therefore could be an "occurrence" that triggered coverage. The Supreme Court remanded the

case to the Circuit Court of Rankin County for further inquiry about the nature of the subcontractor's alleged breach.

Note 1: This is a case of first impression in Mississippi, but this issue has been litigated across the country and courts have split. The *Architex* court quoted from and relied on an article from an article by David Dekker, Douglas Green & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28 *Construction Lawyer* 19 (Fall 2008). An updated version of this article is available at [http://www.constructionweblinks.com/Resources/Industry\\_Reports\\_Newsletters/20081222/more.html](http://www.constructionweblinks.com/Resources/Industry_Reports_Newsletters/20081222/more.html).

Note 2: The CGL policy excludes coverage for the insured's own work, but also makes an exception to this exclusion for work done by the insured's contract. In other words, *Architex* as the insured and contractor could not assert a claim for damage caused by its own work, but it could assert a claim for damage caused by alleged negligence of its subcontractor. (See Note 5 about how this quirk, which applies only in the contractor/subcontractor context, affected the court's decision).

Note 3: The court's decision identifies the particular policy at issue as an Insurance Services Office (ISO) form. ISO prepares hundreds of different policies and endorsement forms. All of the policy language quoted in the case is in the basic CGL form (CG 000 01 10 01 for insurance mavens). In other words, the policy form at issue in this case was a common, industry-standard form, so the court's parsing of the language of the policy could be useful in other contexts.

Note 4: The circuit court relied primarily on two cases, *United States Fidelity & Guaranty Co. v. Omnibank*, 812 So.2d 196 (Miss. 2002), and *ACS Construction Co. v. CGU*, 332 F.3d 885 (5<sup>th</sup> Cir. 2003). In the *Omnibank* case, the Mississippi Supreme Court was responding to a question about Mississippi law certified from the Fifth Circuit: "whether, under Mississippi law, an insurer's duty to defend under a general commercial liability policy for injuries caused by accidents extends to injuries unintended by the insured but which resulted from intentional actions of the insured if those actions were negligent but not intentionally tortious." Ramsay borrowed money from Omnibank secured by a car. Omnibank force-placed insurance on the car. Ramsay filed a class-action asserting fraud, breach of contract, etc. against Omnibank. The bank made a claim against its insurer, USF&G, to defend the claim. According to the decision, Omnibank argued that the insured had coverage as long as the insured did not intend to cause "bodily injury" or "property damage." The *Omnibank* court wrote that "bodily injury" or "property damage" had to be caused by an "accident" in order for coverage to exist, and that an accident produces unintentional results. As defined by the policy, the action was the insured's action and not unintended consequences of that act. In this case, while the bank did not intend to get sued, the bank intended to make the loan to Ramsey, intended to require Ramsey to maintain insurance on the collateral, intended to force-place the insurance, and intended to charge the premiums to Ramsey. Getting sued by Ramsey was an unintended consequence of these actions, and therefore no coverage existed. The court answered the certified question as follows: "an insurer's duty to defend under a general commercial liability policy does not extend to negligent actions that are intentionally caused by the insured." The *Architex* court distinguished the *Omnibank* case on the basis that in *Omnibank* "the insured's intentional actions did not constitute "accidents," and the damages resulting therefrom did not amount to "occurrences" under the respective policies. In the present case, by contrast, the only act or conduct considered by the circuit court was the hiring of subcontractors, without consideration of whether the underlying

acts or conduct of the insured or the subcontractors proximately causing "property damage" were negligent or intentional or were otherwise excluded by policy language.”

Note 5: In the ACS case, ACS was hired to construct munitions bunkers for the Corps of Engineers. The contractor hired a subcontractor to work on the roof. The roof leaked, and ACS had to pay to make repairs. ACS filed a claim for the cost of repairs with its CGL insurer. Following *Omnibank* and other Mississippi cases, the Fifth Circuit held that faulty workmanship of the subcontractor did not constitute an “occurrence” under the CGL policy. The *Architex* court wrote that the exclusion in the policy for the insured’s work, and the exception to the exclusion for a subcontractor’s work, would not make sense unless an “occurrence” included a subcontractor’s faulty work.

### **STATUTES THAT SHOULD BE AMENDED TO ADDRESS LLC’S**

Limited liability companies currently seem to be the preferred form of entities for real estate these days. But many Mississippi statutes that are relevant to real estate still address corporations only. Examples include Section 15-1-11 (statute of limitations to recover land due to defects in corporate formalities); Section 27-7-308 (exception for withholding five percent of proceeds when seller is a foreign corporation); and Section 89-1-21 (how a corporation conveys land). Isn’t it time that these statutes were amended to include limited liability companies and limited partnerships?

### **PROPERTY INSURANCE AND THE OIL SPILL**

The courts will have ample opportunity to decide the extent to which damage to property from the Deepwater Horizon oil spill is covered by property insurance. Here are some general observations about potential coverage under standard forms of property insurance.

First, under most forms of property insurance, the “covered property” is limited to buildings and does not include land only. So oil washed up on a beach may not constitute damage to “covered property.”

Second, most forms of property insurance provide for removal of “pollutants” if the release of the pollutants is a “covered loss”. Covered losses include fire, lightning, and explosions. Whether the oil from the Deepwater Horizon spill is a “pollutant” caused by a “covered loss” will undoubtedly be the subject of litigation.

Third, after Hurricane Katrina, most policies were amended by a Water Exclusion Endorsement that specifically excludes coverage for any waterborne material. Oil carried onshore by flood or hurricane waters arguably would fall within this exclusion from coverage. However, even if waterborne oil is excluded from property insurance, flood insurance policies may provide some coverage. FEMA stated in a June 7, 2010 memorandum that the Standard Flood Insurance Policy would be cover oil in flood waters.

Fourth, the standard coverage language is limited to “direct physical loss of or damage to Covered Property.” This language arguably would exclude claims for loss based on canceled hotel or condominium reservations.

The good news for owners is that they may be able to recover from BP through the BP claims process for damages that are not covered under their property insurance.

The commercial general liability (CGL) policy may provide coverage for expenses incurred to clean up oil. In one recent case, a court held that a claim for cleanup costs of an oil spill was covered by a CGL policy. In this case a contractor broke a heating oil line in a house. The heating oil leaked into the basement. The state environmental agency required the contractor to clean up the oil. The contractor hired Clean Harbors to clean up the oil and made a claim against its insurer under its CGL policy. The policy had standard language excluding coverage for any expense arising out of a demand by the government to clean up or a claim by a government for damages because of a clean up; however, property damage that the insured would have had regardless of a claim or demand by a government was not excluded. The court held that the exclusion did not exclude common-law restoration costs. *Clean Harbors Environmental Services, Inc. v. Boston Basement Technologies, Inc.*, 916 N.E. 2d 406 (Mass. 2009).

### **BUILDER MUST BE LICENSED AT TIME OF ACTION, NOT TIME OF WORK**

*Lutz v. Weston*, 19 So. 3d 60 (Miss. 2009). Barry Lutz obtained a residential builder's license in his name in 1999. In 2001 he formed a corporation, Lutz Homes, Inc. Lutz Homes, Inc. and the Westons entered into a contract in 2005 for Lutz to construct a home for the Westons. Lutz Homes, Inc. did not have a residential builder's license at this time, though Barry Lutz did have a license. In 2006 a dispute arose between Lutz and the Westons. The Westons refused to pay Lutz and Lutz filed a contractors lien against the property in April 2006. Barry Lutz requested that the Board of Contractors name Lutz Homes, Inc. as the license holder. The Board granted this request on August 11, 2006. In October 2006 the Westons filed an action against Lutz Homes and Barry Lutz claiming breach of contract and slander of title for filing the construction lien. The Westons argued that the failure of Lutz Homes, Inc. to have the license at the time the work was done rendered the contract void. Section 73-59-9(3) of the Mississippi Code provides that a residential builder who does not have a license may not enforce the contract. Barry Lutz and Lutz Homes filed a counterclaim against the Westons for breach of contract. The trial court dismissed the counterclaim based on the failure of Lutz Homes to have a license at the time the work was done. On appeal, the Mississippi Supreme Court, in a decision by Justice Waller, reversed and remanded. The Supreme Court held that the statute only required that the builder have a license at the time that the builder filed its action to enforce the contract, not at the time that the cause of action accrued.

Note 1: It is easy to be sympathetic to the builder in this case since the builder in fact had a license in his own name at the time that he did the work, and apparently failed to go through the formality of having the license transferred to his corporation. But this fact is not relevant to the court's holding; under the court's holding, an unqualified builder could ignore the licensing requirement, build a house, and seek a license only after trouble arose. If the purpose of the statute requiring builders to get licenses is to make sure that people who build houses meet certain minimum requirements to protect the safety of the public in purchasing houses, then permitting a builder to obtain a license after the work is done and still enforce the contract is contrary to the purpose of the statute.

Note 2: The *Lutz* court declined to follow a 2004 decision of the United States Court of Appeals for the Fifth Circuit which held that Section 73-59-9 requires that the builder have a license at the time that the work was done rather than when the builder enforces the contract. *Libbey v. Ridges*, 113 Fed.Appx. 3, 2004 WL 1835997 (August 17, 2004). As noted above, the Mississippi Supreme Court in the *Architex* case declined to follow a prior decision of the Fifth Circuit. Most readers know that the Mississippi Supreme Court, in another decision by Justice Randolph, forcefully declined to follow prior decisions of the Fifth Circuit regarding Mississippi law in the Katrina insurance case, *Corban v. United Services Automobile Ass'n*, 20 So. 3d 601 (Miss. 2009). Is there a trend here?

#### GENERAL

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